TASMANIA

GOVERNMENT
PRICES
OVERSIGHT
COMMISSION

Investigation of Metro Pricing Policies

Issues Paper

February 2000

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Overview

The Commission has been required to investigate the Metro Tasmania Pty Ltd (Metro) pricing policies for its bus services in Hobart, Launceston and Burnie and Ulverstone. The Commission is required to produce a Final Report, including recommendations for maximum prices to be charged over the next three years, by 2 June 2000.

The Commission is seeking community input to the Investigation through submissions and meetings.

This Issues Paper is being released to assist the community to prepare initial submissions to the Investigation. A Draft Report, which will include the Commission's draft proposals, will be released in April and the Commission will seek comments on its research and proposals before preparing its Final Report and recommendations. The Commission also proposes to consult with interested parties during the course of the Investigation to discuss particular matters.

Metro[1] provides urban public transport services in Hobart, Launceston and Burnie.

The principal objective of Metro as stated in Section 5 of the *Metro Tasmania Act 1997* is:

> …to provide road passenger transport services in Tasmania and to operate those services in a manner consistent with sound commercial practice.

Metro has a contract with the Government for provision of Community Service Obligations (CSOs). The contractual arrangement replaced the previous system of funding.

In 1998-99, Metro provided about 1 600 route services per day in Hobart, 550 in Launceston and 180 in Burnie (including Wynyard and Ulverstone). In aggregate, services in these three centres covered 10.4 million bus kilometres annually and provided about 9.6 million passenger trips per year.

Since the 1996 Investigation, there has been a continual decline in patronage. Total first boardings have fallen about 17 per cent since 1995-96. The following table shows the decline in patronage (first boardings) during this period.

[1] Services were previously provided by the Metropolitan Transport Trust (MTT). The Government corporatised MTT on 2 February 1998 as part of its transport reform package, vesting the ownership and management responsibility for services previously provided by the MTT in a new state-owned corporation, Metro Tasmania Pty Ltd (Metro).

1995-96	1996-97	1997-98	1998-99
9 304 000	8 530 000	8 060 000	7 748 000

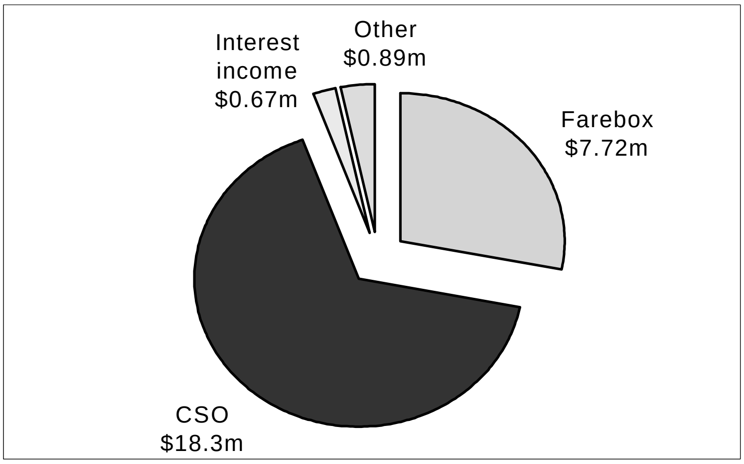
Metro forecasts that the declining trend may continue, citing a declining of population and high levels of unemployment in the State as two major contributing factors.

The Commission is interested in the community's views on the reason for the continual declining of Metro's patronage.

There has been no Metro fare increase since the 1996 Investigation. The last fare increase of 10-20 per cent occurred in 1996, following which patronage declined by about 8.3 per cent.

Recent interstate fare comparison indicates that Metro's fares are among the lowest of all public bus services in other capital cities.

Operating revenues of Metro include income from fares and charters ($27.65 million in 1998-99) and Government funding for CSOs ($18.3 million in 1998-99). Only 28 per cent of Metro's total revenue is from fare-box and CSO funding accounts for nearly 67 per cent of its total revenues (see figure below).



Metro notes in its submission that its operating expenditure per bus kilometre has decreased by 29 per cent over the previous 10 year period and that its unit costs have been reduced significantly over the period since the 1996 Investigation (overall by 11 per cent). An underlying improvement in overall cost effectiveness has resulted in a general improvement in profitability over the same period.

Since the 1996 Investigation, Metro has achieved significant cost savings. The following table shows the extent of the costs savings since 1995-96.

Cost Category	Change in Unit Costs (Real Terms)
Drivers	-12.8
Bus Running	-7.6
Bus Repairs & Maintenance	-21.3
Overheads	+5.2
Standardised Costs (excluding Bus Capital Charge)	-9.5
Bus Capital Charges	-34.0

However, Metro continues to compare unfavourably with private operator costs. Average labour costs, drivers per bus hour costs, overheads and bus repairs and maintenance costs are all above the private sector benchmark levels. Metro submits that whilst it is possible to achieve further productivity and efficiency gains, there will always remain a significant gap due to award conditions and unit rate differences inherent between public and private employees.

A recent study commissioned by Metro shows that Metro was 'mid-range' compared to other benchmarked operators in terms of cost recovery, ie the ratio of non-government returns to total operating costs. However, Metro notes that the cost recovery ratio indicator needs to be considered in tandem with the interstate comparison of average total fare levels (as opposed to average fares for given classes of passengers), where Metro rates as being among the lowest.

The Commission is seeking comments on

- *the appropriateness of setting benchmark targets for cost efficiencies at the level of efficient private sector operators, and/or the appropriate efficiency targets across all areas of Metro's operations; and*
- *the appropriate level of cost recovery for Metro.*

Under the *Government Prices Oversight (MTT Bus Fares) Order 1997*, Metro's fare increase is indexed to CPI. Metro submits that the CPI basis is unsatisfactory and the School Bus Index better reflects actual circumstances affecting bus operations.

The Commission invites comment on the appropriate base upon which future Metro fares should be indexed.

The Terms of Reference require the Commission to investigate Metro's pricing policies and to make recommendations 'in relation to the appropriate maximum prices in respect of these bus services to be charged by Metro during the three years after the completion of the Final Report.' The Order that is to be made by the Minister will then set 'maximum prices'.

The Terms of Reference are not specific about whether the maximum prices in regard to Metro's total revenues, or whether the Commission is required to recommend maximum fares.

In the 1996 Investigation, the Commission recommended maximum prices as the total revenue which Metro may earn for the provision of timetabled route serviced. These maximum revenues were to be indexed annually. The Commission also recommended a set of pricing principles to be recognised in the setting of fares.

In addition to the broad approach taken in the 1996 Investigation, the Commission and the Minister have a range of options in specifying the form of maximum prices. These include, the specification of maximum fares that Metro may charge for individual tickets, the specification of average fares, and combinations of the above.

The Commission invites comments on the form of its recommendations.

Metro's submission shows that the majority of its passengers are from low income or welfare recipient households. Metro submits that any significant increases could severely affect those people and may consequently restrict their mobility altogether. In addition, Metro observes that:

> In such circumstances demand for services will decline and pressure to reduce or remove poorly utilised services will increase, which if successful will result in deterioration of services and in further patronage losses.

The Commission is seeking comments on the social impact of any fare increase on Metro's passengers.

Following the Investigation, the Government will determine the maximum fares that the Metro may charge for the following three years, and the Metro will be required to re-set its fares to conform with the Government's requirements.

Chapter 1 - Introduction

1.1 Terms of Reference

The Government Prices Oversight Commission (the Commission) is required by the Treasurer to conduct an investigation into the pricing policies of Metro Tasmania Pty Ltd (Metro). The Commission is required to produce a Final Report by 2 June 2000 in which it will make recommendations on the maximum prices to be charged by Metro for passenger bus services for the next three years.

The Terms of Reference for the Investigation are reproduced in Appendix A. Essentially, the Commission is required to:

> …investigate the pricing policies associated with the current provision of scheduled route services by Metro in the metropolitan areas of Hobart, Launceston and Burnie and the town of Ulverstone.

1.2 Matters to be Taken into Account

Apart from the specific issues raised in the Terms of Reference, Section 31 of the *Government Prices Oversight Act 1995* specifies certain matters that the Commission must take into account in any investigation. This section of the Act is reproduced in Appendix A. These matters include:

- ❖ the cost of supplying or providing the monopoly service;
- ❖ any interstate benchmarks for prices, costs, revenues and returns on assets;
- ❖ the need to protect consumers from the adverse effects of the exercise of monopoly power;
- ❖ the need for the monopoly provider to be financially viable;
- ❖ the need for a reasonable return to the State, including the payments of dividends;
- ❖ any community service obligations; and
- ❖ the quality of the supply of the monopoly service.

1.3 Background to the Investigation

The Commission is an independent statutory body. It was established in 1996 following the commencement of *the Government Prices Oversight Act 1995*. Its role is to investigate the pricing policies of Government Business Enterprises (GBEs), Local

Government Business and Agencies that are monopoly providers of goods and services in Tasmania.

The Commission has been set up as part of Tasmania's commitment to the National Competition Policy (NCP) Agreements which were signed by the Council of Australian Governments (COAG) in April 1995. The purpose of the NCP is to promote competition in the interests of efficiency and economic growth, while dealing with social objectives and concerns about market failure.

As a guiding principle, the NCP anticipates that competition should not be restricted by legislative barriers unless it can be demonstrated that:

- the benefits to the community as a whole outweigh the costs; and
- the objectives of the legislation can only be achieved by restricting competition.

The NCP Agreements specifically include a requirement that State and Territory Governments consider establishing an independent source of prices oversight advice for their monopoly GBEs. Commonwealth prices oversight is to apply in the absence of an appropriate State body.

The COAG Competition Principles require an independent source of prices oversight advice with the following characteristics:

- it should be independent from the Government Business Enterprise whose prices are being assessed;
- its prime objective should be one of efficient resource allocation but with regard to any explicitly identified and defined community service obligations imposed on a business enterprise by the Government or legislature of the jurisdiction that owns the enterprise;
- it should apply to all significant Government Business Enterprises that are monopoly, or near monopoly, suppliers of goods or services (or both);
- it should permit submissions by interested persons; and
- its pricing recommendations and the reasons for them should be published.

An outline of the legislative and policy framework relating the Commission is provided in Appendix B.

The Commission established for this Investigation comprises Andrew Reeves (Commissioner) and Paul Baxter (Assistant Commissioner).

1.4 Metro Submission to the Investigation

Metro has provided the Commission with a comprehensive submission, drawing on two recent studies. These provide an analysis of Metro’s operational costs and an analysis of

patronage, including possible initiatives to reverse the declining trend. A copy of the submission is available from the Commission's website (www.gpoc.tas.gov.au/investig.htm) and hard copies may be obtained from the Commission or from Metro.

1.5 Previous Metro Investigation

The Commission conducted its first investigation into the pricing policies of Metro in 1996. The Commission concluded its Investigation and handed down the *Metro Fares Investigation Final Report 1997* in February 1997. The final report contained recommendations arising from the Investigation.

After considering the Commission's recommendations, the Government determined the maximum fares to be charged by Metro and these were set out in *the Government Prices Oversight (MTT Bus Fares) Order 1997* (the 1997 Order).

1.6 Key Developments since 1996 Investigation

1.6.1 Corporatisation of Metro

Prior to February 1998, urban public transport services in Hobart, Launceston and Burnie were provided by Metropolitan Transport Trust (MTT), a statutory authority constituted by the *Metropolitan Transport Act 1954*.

The Government corporatised MTT on 2 February 1998 as part of its transport reform package by:

- ❖ repealing the *Metropolitan Transport Act 1954*;
- ❖ passing the *Metro Tasmania Act 1997* – vesting ownership and management responsibility for services previously provided by the MTT in a new state-owned corporation, Metro Tasmania Pty Ltd; and
- ❖ transferring public policy and regulatory powers formerly vested in MTT to the administrative control of the then Department of Transport (now the Department of Infrastructure, Energy and Resources).

The principal objective of Metro as stated in Section 5 of the *Metro Tasmania Act 1997* is:

> …to provide road passenger transport services in Tasmania and to operate those services in a manner consistent with sound commercial practice.

Prior to corporatisation, MTT entered into a contract[2] (the Contract) with the Government on 31 October 1997 for the provision of Community Service Obligations (CSOs). The contractual arrangement replaced the previous system funding for the provision of services.

The services required to be undertaken were those that were in existence as at the date of the signing of the Declaration of the CSOs with fares required to be consistent with those provided in the *Government Prices Oversight Commission (Metro Fares) Order 1997*. The standards and quality of service under the Contract are defined to be those as specified in Metro's Customer Service Charter dated 27 June 1997, as updated from time to time. The Charter outlined MTT's obligations to its customers and provided complaint mechanisms in the event that MTT fails to deliver. Upon the corporatisation of MTT, the contractual rights and obligations under the Contract were transferred to Metro. A copy of the Metro's Customer Service Charter 1999 can be obtained from Metro Tasmania. A more detailed discussion of Metro's CSOs is provided in Chapter 4.

1.6.2 Acquisition of Hobart Coaches

Metro acquired Hobart Coaches in May 1999 through a subsidiary company Metro Tasmania Coaches Pty Ltd. The business name 'Hobart Coaches' was retained as the trading name for the transport services.

The acquisition of Hobart Coaches enabled Metro to expand its services to the communities of Kingston, Blackman's Bay, Richmond, New Norfolk, Channel and Cygnet.

The main users of Hobart Coaches are school students, concession card holders and adult commuters. The company plans to continue its financial arrangement with the Government by being reimbursed on a monthly basis for the difference between fares charged and the approved commercial fare.

Although Hobart Coaches is a subsidiary of Metro, the Terms of Reference of Metro Fares Investigation do not cover Hobart Coaches.

1.6.3 Devonport Bus Service

In response to the Government's election commitment, a Metro style bus service was introduced into Devonport in February 2000. The new bus service replaced previous bus services, which focused largely on student travel needs, with an integrated student and general route services of a similar standard to the Metro system.

[2] The Crown in Right of the State of Tasmania and Metropolitan Transport Trust Agreement, 31 October 1997.

A local private bus operator, Mersey Bus & Coach, was successful in tendering for the bus service contract. The service contract is of five year duration with a five year extension option if performance benchmarks are met.

The new Devonport bus service, MerseyLink, has adopted Metro's fare structures. Hence, although this Investigation does not cover bus services in Devonport, it may affect indirectly MerseyLink's future pricing policy.

1.6.4 Abolishment of Vehicle Licensing System

The Government introduced legislation reforming the public transport industry in late 1999. The proposed reforms include the elimination of the vehicle licensing system and replacing it with transport legislation designed to promote safety, competition, efficiency and quality. It is expected that the legislation will be proclaimed in May 2000.

Once the new legislation is in operation, transport operators, including Metro, may have their operations opened to competition sometime after June 2000.

1.6.5 The New Tax System

The introduction of the Goods and Services Tax (GST) in July 2000 will affect the cost and fare structures of Metro. In developing its recommendations, the Commission will examine the effect of GST on Metro's costs and revenue. This is discussed in detail in Chapter 5.

1.7 Program and Consultation

The Commission encourages public participation in the Metro Investigation.

This Issues Paper has been produced to inform interested parties of the major issues and to explain the Commission's approach to the Investigation. The Commission encourages submissions on any of the matters raised in this Paper and in the Metro submission and on any aspect of the Terms of Reference.

The closing date for submissions to be made to the Commission on this Paper is 10 March 2000.

On the basis of its research, the submissions received on the Issues Paper and consultations with interested parties, the Commission will prepare a Draft Report which will be released in early April 2000. The Draft Report will contain the Commission's draft proposals and a further round of public comments and submissions will be sought on these matters.

After taking into account the responses to its Draft Report, the Commission will publish its recommendations in a Final Report by 2 June 2000.

Chapter 2 - Form of Recommendation and the Order that sets Maximum Prices

2.1 Introduction

The Terms of Reference require the Commission to 'investigate the pricing policies associated with the current provision of scheduled route services by Metro in the metropolitan areas of Hobart, Launceston and Burnie and the town of Ulverstone' and to make recommendations 'in relation to the appropriate maximum prices in respect of these bus services to be charged by Metro during the three years after the completion of the Final Report.' The Order that is to be made by the Minister will then set 'maximum prices.'

The Terms of Reference are not specific about whether the maximum prices are in regard to Metro's total revenues, or whether the Commission is required to recommend maximum fares.

The Commission and the Minister have a range of options in specifying the form of maximum prices. These include, as discussed below, the setting of maximum revenues that Metro may earn from the combination of fare-box receipts and subsidies, the specification of maximum fares that Metro may charge for individual tickets, the specification of average fares, and combinations of the above.

This Chapter explores some of the issues associated with selection of the form of maximum prices.

2.2 Form of Maximum Prices

The Act[3] states that maximum prices may be expressed in one or more of the following terms:

- the cost of supplying or providing the monopoly service;
- the need to protect consumers from the adverse effects of the exercise of monopoly power;

[3] *Government Prices Oversight Act 1996*, Section 31.

- the need for the monopoly provider to be financially viable;
- any community service obligations; and
- the quality of the supply of the monopoly service.

2.2.1 Previous Approach

In the Final Report of the 1996 Investigation, the Commission recommended maximum prices as the total revenue which Metro may earn for the provision of timetabled route services. These maximum revenues were to be subject to a pre-determined basis for adjustment.

The Commission also recommended a set of pricing principles to be recognised in the setting of fares.

However, the Order made by the Minister expressed maximum prices as the maximum fares that Metro may charge patrons.

The Commission is seeking comments on whether it is desirable for it to repeat the broad approach adopted in the 1996 Investigation, or whether it is desirable that there be a symmetry between the form of the recommendation and the form of the Order.

2.3 Metro Incentives

The form of the recommendation and of the Order has an important impact on Metro's conduct. It is desirable that Metro is given a commercial incentive to:

Provide the services it is contracted to provide, at the lowest cost commensurate with the required quality standards.

Choices such as fleet mix should be at the discretion of Metro, which is best placed to make the necessary judgements.

Increase patronage where it is cost-effective to do so, or where increased patronage meets Government's policy objectives expressed in the Metro Contract.

With the possible exception of some routes during peak periods, additional passengers could be carried at little, if any, additional cost. Subject to any underlying trend for reduction in patronage, there is then the potential for Metro to increase profits or to reduce the payment under the Contract, or for the Government and Metro to share the benefits. This would be a desirable feature of the Contract. If the Order specifies maximum revenues, Metro would have no incentive to promote increased patronage. Conversely, if the Order specifies maximum fares, Metro has a strong incentive. If the Contract sets a payment on a patronage basis, Metro would have the strongest incentive to increase patronage, but at the expense of Government through additional payments under the Contract.

Provide services that best meet the needs of the community.

It is apparent from the Metro submission and from experience in Tasmania and elsewhere that the nature of the demand for public transport is changing rapidly. Timetabled fixed route services were once adequate, but there is increasing community need for greater flexibility and a broader range of public transport services.

Metro is well-placed to assess the transport needs of the community and has adopted a number of innovations, including 'Doorstopper' services, to address particular needs. It should be encouraged to continue to improve not only the efficiency but also the effectiveness of its services to the community.

Such new services may not fully recover costs (since few if any of Metro's services do so), but the social benefit of these innovations may be greater than for the standard timetabled route services. Unless Metro is either required under the Contract or receives a financial benefit, there is little commercial incentive for Metro to reach 'best practice' in meeting community needs.

2.3.1 Allocation of Risk

Metro potentially faces financial risks through changes in costs of fuel, salaries and wages, financing charges, materials and other supplies. Its revenues are dependent on fares and on patronage. Many of these factors are outside Metro's control, and the form of the Order and the Contract allocates these risks to Metro, to passengers or to the Government through the payment arrangements.

In principle, the risks should be allocated to the party best able to manage the exposure. To the extent that the risks are general to the industry and not in the control of any party, (such as the risk associated with movements in fuel prices), the response in a competitive market would be a commensurate increase in prices. For Metro, where the end customer pays only a small proportion of the total cost, it may be appropriate that the impact of changes in industry-wide costs is shared between Metro patrons and the Government through the Contract.

2.4 Options for the Form of Recommendation

Options and some of the issues associated with the form of the recommendation include:

2.4.1 Specification of Maximum Revenues

2.4.1.1 Reflecting changes in costs

The 1997 recommendation expressed recommended total revenues in 1996-97 currency, implying an escalation of the amounts by annual changes in the Consumer Price Index (CPI) or some other measure. Since the maximum revenues would be set to provide appropriate revenues to recover capital costs (including a return on equity) and operating costs for an efficient level of operations, it may be appropriate that maximum revenues

be adjusted periodically to reflect changes in Metro's underlying cost structure. The Metro submission proposes that allowable charges be indexed with changes in the School Bus Index.

The Commission proposes to compare the composition of this Index with the composition of Metro's costs. If such a cost-based formula is adopted, the business risks (and benefits) of underlying changes in costs are passed through to Government, or to patrons, or shared between these two client groups.

2.4.1.2 Reflecting changes in services

The 1997 recommendation was in regard to the 'current levels of timetabled services required of the MTT'. This implied that any changes in the levels of service required of Metro would be reflected in adjustments to the total revenues, but without specifying how this may be carried out.

The Commission is considering accommodation of the prospect of changes in services in its recommendations of maximum prices. This could be given effect through a pricing formula, reflecting service kilometres in its simplest form, or service kilometres required during periods — peak, interpeak, evening and weekend. These periods are characterised by different costs for Metro operations, by virtue of bus requirements, driver penalty rates, etc. A more accurate adjustment may reflect conditions, eg route location (CBD or suburban), route length or terrain which impact on fuel consumption and other bus operating costs, but the additional sophistication may not be warranted.

The Commission is seeking comments on the merits of this approach and the factors which should be reflected in such a price formula.

2.4.2 Recommendations of Fares

The Commission has previously taken the view that its role is primarily an economic regulator. It has not considered that it is appropriate for it to incorporate social, environmental, transport or public policy matters in its recommendations, as to do so would be to intrude into matters that are the province and responsibility of Government. For this reason, it confined itself in the 1996 Investigation to making recommendations of maximum revenues required to provide services at efficient levels of costs. Nevertheless, it recognises that information it gathers in the course of an investigation is an aid to the decisions of Government. In the 1996 Investigation, the Commission included its estimates on the potential impact on fare-box revenue of changes in fares, taking into account the likely impact on patronage.

The Contract between Metro and the Government is arguably the most appropriate vehicle for the Government's expression of the services it requires Metro to provide for the community and, since the Contract should specify the amount (or the formula used to determine the amount) of payment, the maximum fares which it expects Metro to charge.

In the absence of information on the amount of payment which the Government is prepared to contribute to Metro's operations over the pricing period, the Commission is not able to make recommendations on fares. However, the Commission may follow its previous practice and illustrate the likely impact of changes in fares on fare-box receipts, and hence on the required level of payment.

A further question is whether Metro or the Government is best-placed to determine fare policy. Metro may be better informed of the likely customer response to changes in fares, and could be given the flexibility to determine the relative mix of fares, within a framework of pricing principles. The framework could specify maximum average rates of increase (or minimum average rates of decrease) within side constraints such that an individual fare may not increase by more than a certain percentage or a certain amount per annum or within the three year period. Such an approach would provide Metro with an incentive to increase total fare-box revenue through a combination of fare adjustment and patronage initiatives, but within bounds to protect the interests of particular groups of patrons.

Specification of maximum average fares is also desirable to enable Metro to implement moderate increases in individual fares by rounded increments. The Metro submission states that the form of the current Order effectively prevents it from increasing fares even by the CPI as an increase to the next rounded increment would breach the indexed limit.

The Commission seeks comment on the form of the recommendations.

Chapter 3 - Metro Operations

3.1 Services and Patronage

Metro provides urban passenger bus services in the cities of Hobart, Launceston and Burnie (including Wynyard and Ulverstone). Services include school services, passenger route services and a range of charter services.

Metro operates weekday services in Hobart, Launceston and Burnie, evening services in Hobart and a minor evening service in Launceston. Weekend and public holiday services are only available in Hobart and Launceston.

In 1998-99, Metro provided about 1 600 scheduled route services per day in Hobart, 550 in Launceston and 180 in Burnie (including Wynyard and Ulverstone).[4] In aggregate, services in these three centres covered 10.4 million bus kilometres annually and provided about 9.6 million passenger trips per year.[5] Table 3.1 below shows annual passenger trips from 1994-95 to 1998-99.

Table 3.1: Passenger Trips (including transfers, charter and contract services)

	Hobart	Launceston	Burnie	Total
1994-95	8 750 000	2 270 000	750 000	11 770 000
1995-96	8 583 000	2 261 000	714 000	11 558 000
1996-97	7 908 000	2 086 000	645 000	10 639 000
1997-98	7 390 000	1 993 000	613 000	9 996 000
1998-99	7 165 000	1 855 000	548 000	9 568 000

Source: Metro Annual Report 1998-99

3.2 Metro Patronage

Passengers of Metro’s timetabled services are classified into three categories:

- adult (full fare);
- adult concession (including tertiary students); and
- child/student.

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[4] Metro submission, p36.

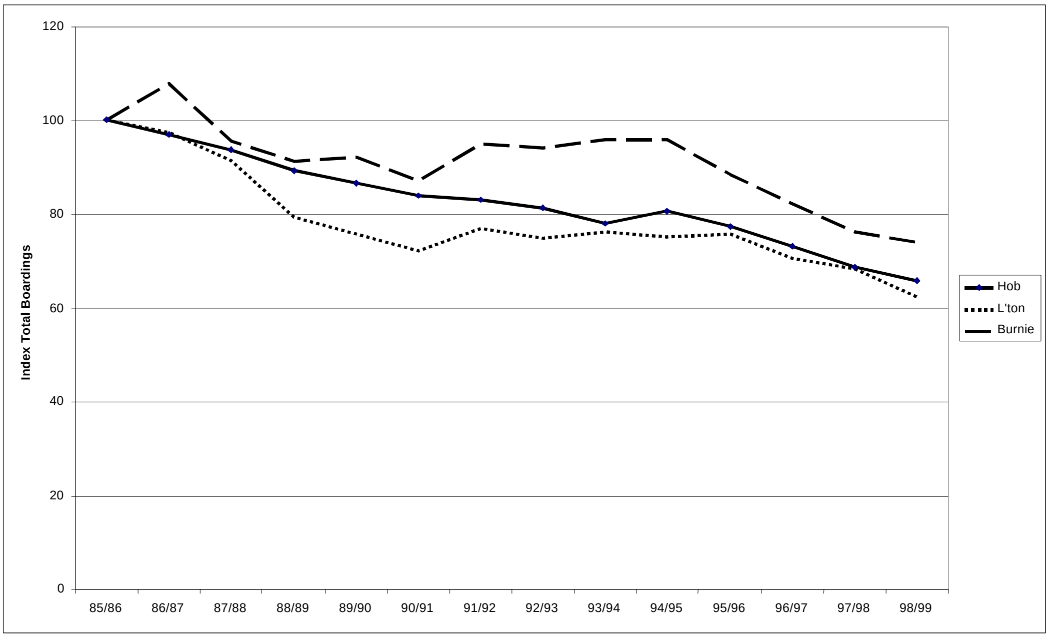
[5] Metro submission, p9.

3.2.1 Metro Patronage Trends

3.2.1.1 Patronage trends since 1985-86

Since 1985-86, patronage in each of the three categories has fallen in all three centres. Figure 3.1 below shows that from 1985-86 to 1998-99, total patronage fell by 34 per cent (3.2 per cent per annum) in Hobart, 38 per cent (3.4 per cent per annum) in Launceston, and 26 per cent (2.3 per cent per annum) in Burnie. In particular, Figure 3.1 shows that over the three years since 1995-96, patronage fell sharply in all three centres – 5.2 per cent per annum decline in Hobart, 6.3 per cent per annum in Launceston and 5.7 per cent per annum in Burnie.

Figure 3.1: Patronage Trend (all passengers) 1985-86 to 1998-99

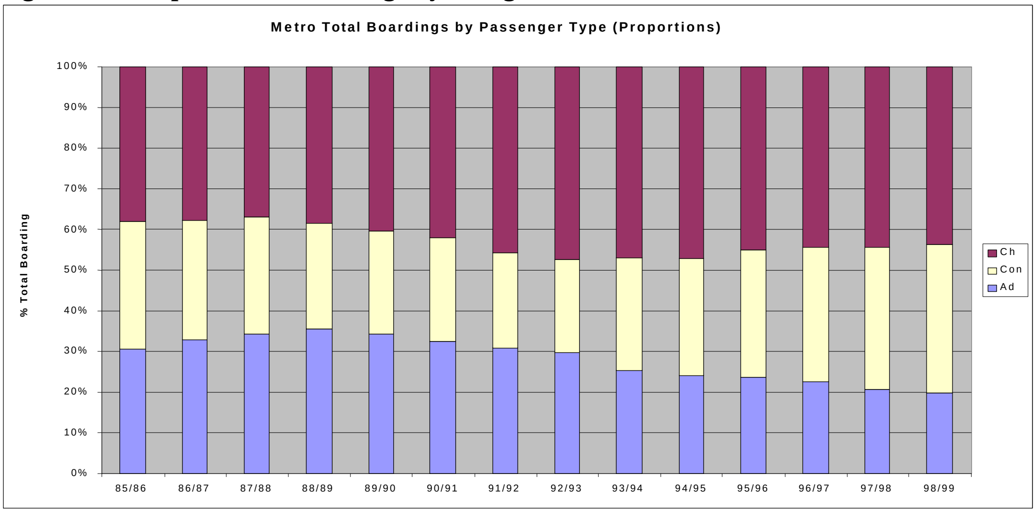


Source: Metro submission, Appendix E, p49.

Full adult patronage has fallen most rapidly since 1985-86, with an overall fall of 57.5 per cent (6.4 per cent per annum). For the same period, child/student patronage has fallen 25 per cent (2.2 per cent per annum) and adult concession patronage has fallen 24 per cent (2.1 per cent per annum). Figure 3.2 below shows that the proportion of full fare adults started to decline in 1988-89. The proportion of full fare adults has fallen from 35 per cent of the total patronage in 1988-89 to 20 per cent in 1998-99. Figure 3.2 also shows that since 1992-93 the proportion of adult concession patronage has been increasing while the proportion of children/students has been falling, reflecting an increase in adult concession patronage between 1992-93 and 1994-95 and a lower rate of decrease in adult concession patronage after 1994-95.[6]

[6] See Metro submission, Figure E3, p50.

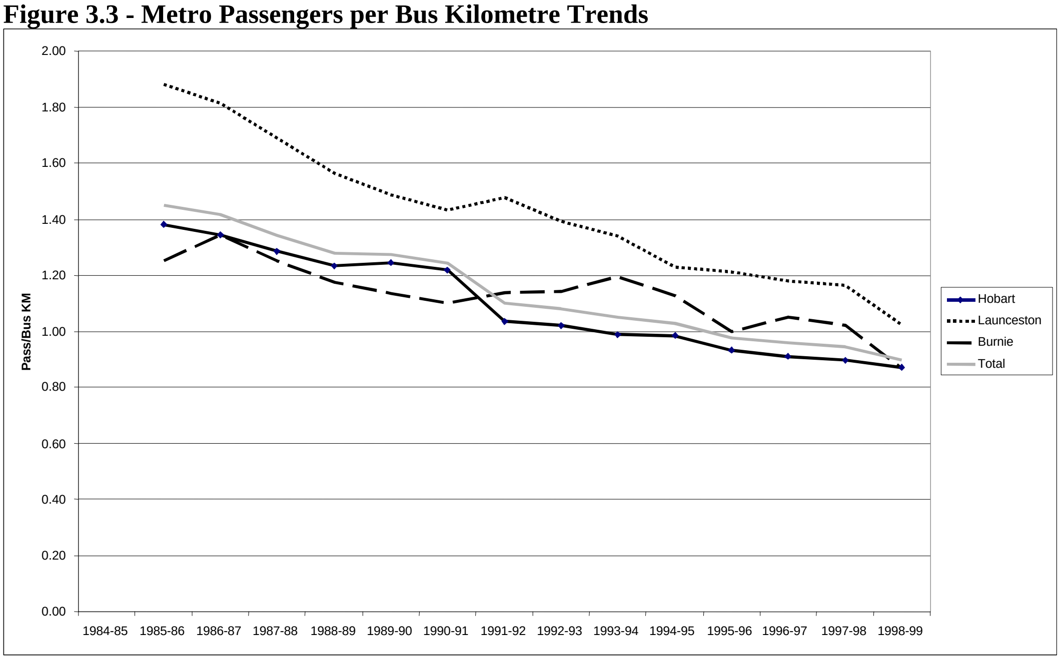
Figure 3.2: Proportion of Patronage by Categories



Source: Metro submission, Appendix E, p52.

Since 1985-86, total bus kilometres in each centre has increased by around 10 per cent while the patronage levels have been falling. Increases in services have not been sufficient to compensate for the apparent loss of bus patronage. As a result, the average bus loadings for the three centres have fallen by around 35 per cent to 40 per cent. The passenger boardings/bus kilometre ratios have fallen by 37 per cent in Hobart, 46 per cent in Launceston and 30 per cent in Burnie. Figure 3.3 below summarises the trends in Metro passengers per bus kilometre since 1985-86.

Figure 3.3 - Metro Passengers per Bus Kilometre Trends



Source: Metro submission, Appendix E, p53.

3.2.1.2 Patronage trends since 1996 Investigation

There was a large reduction in first boardings of 8.4 per cent in 1996-97 compared to the previous year. Metro submits that the large decline was due to the nature and extent of the fare increase in 1996[7] (see Chapter 4 for details of the 1996 fare increase). Subsequent years showed a smaller rate of decline in patronage of 5.5 per cent in 1997-98 and 3.9 per cent in 1998-99.[8] Metro attributes the improvements in subsequent years to its efforts and an improving state economy. Table 3.2 below summarises Metro's first boardings on timetabled services since 1995-96.

Table 3.2: First Boardings (excluding transfers, charter and contract services)

Passenger	Number of Trips				Patronage per Categories			
	1995-96 '000	1996-97 '000	1997-98 '000	1998-99 '000	1995-96 %	1996-97 %	1997-98 %	1998-99 %
Adult	2 429	2 131	1 916	1 766	26.1	25.0	23.8	22.8
Adult Conc	2 648	2 563	2 498	2 497	28.5	30.0	31.0	32.2
Child/Student	4 227	3 836	3 646	3 485	45.4	45.0	45.2	45.0
Total	**9 304**	**8 530**	**8 060**	**7 748**	**100**	**100**	**100**	**100**

Source: Metro Annual Reports 1995-96, 1996-97, 1997-98 and 1998-99.

Metro had previously planned to halt the decline in patronage by the year 2001-02.[9] Metro now considers that the impact of GST may make this target impossible to attain.[10] The target date has now been revised to year 2003-04.

Although the current Investigation is concerned with Metro's pricing policy for the next three years, available data concerning Metro's patronage projections are for longer periods.[11]

Table 3.3 below shows Metro's patronage forecast for the next five years (2000-01 to 2004-05). Metro forecasts a reduction in total public transport trips by 12.7 per cent in Hobart, 10.9 per cent in Launceston and 13.6 per cent in Burnie. Metro identifies a declining population and high levels of unemployment in Tasmania as two major factors contributing to the reduction in patronage.

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[7] Metro submission, p34.

[8] Figures based on Metro's Annual Reports for 1995-96, 1996-97, 1997-98 & 1998-99.

[9] Metro submission, p20.

[10] See discussion of the impact of GST on Metro's patronage later in this chapter.

[11] Available data on Metro's patronage projections are for 5, 10 & 15-year periods.

Table 3.3: Patronage Projection for next five years

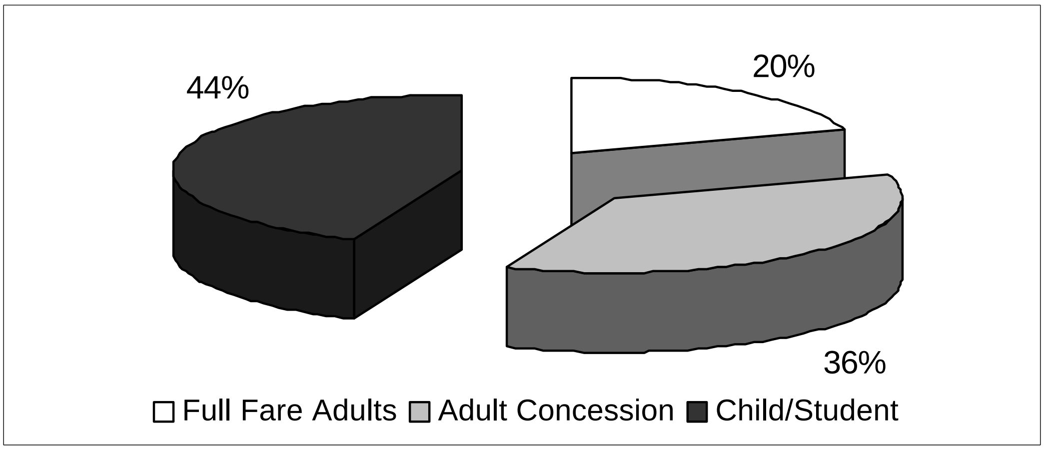
Centre	Decline in Patronage (%)	
	Total Decline	Average Annual Decline
Hobart	12.3	2.46
Launceston	10.9	2.18
Burnie	13.6	2.72

Source: Metro submission, Appendix E, p67.

3.2.2 Current Metro Patronage

In 1998-99 Metro carried about 9.57 million passengers (total boardings), of which 20 per cent were full fare adult passengers, 36 per cent adult concession passengers and 44 per cent child/student passengers[12] (see Figure 3.4 below).

Figure 3.3: Current Metro Patronage



Source: Metro submission, p10.

Ninety-one per cent of Metro's patronage is in the weekday daytime period up to 6.30 pm. Of the weekday daytime patronage 19 per cent is on school special services, 47 per cent is on peak period route services and the remaining 25 per cent on between-peak route services. The remaining patronage is split 1.5 per cent weekday evenings and 7.5 per cent weekends and public holidays.

3.3 Metro Market Share and Market Profile

3.3.1 Market Share

Metro provides about 3.1 per cent of all trips made in Hobart, 2.3 per cent in Launceston and 0.9 per cent in Burnie.[13] Metro notes that bus market share for work trips is significantly higher than for trips overall, in particular for CBD-oriented work trips. Metro caters for about 15 per cent of all work trips to and from Hobart CBD.

[12] Metro submission, p10.

[13] Metro submission, p11.

The bus market share in school trips is estimated at 20-25 per cent for Tasmanian urban areas overall and Metro provides 23 per cent of the school trips by buses.

3.3.2 Metro Market Profile

Metro's full fare passengers have fallen from 35 per cent of total patronage ten years ago to 20 per cent in 1998-99. Metro notes that bus usage is relatively high among the lower income groups. The majority of Metro's passengers are people who are not employed (home-makers, students, pensioners and unemployed) or those in relatively poorly-paid jobs.[14]

A study commissioned by Metro found that 57 per cent of bus users earn less than $16 000 per annum.[15] Only a small percentage of Metro's passengers are user by choice, in the sense of having a car available but using the bus in preference. This means that a bus is often the only viable means of transport for the majority of Metro's passengers.

Metro suggests that its primary role at the present appears to be catering for the transport disadvantaged (those who do not have a car available), many of whom are also economically disadvantaged. As a result, Metro considers that social impacts of any fare increase should be a major consideration in future pricing decisions.

3.4 Reasons for Use of Bus Services

The market research study by Metro and the census data from Australian Bureau of Statistics found that:[16]

- non-availability of a car was the major reason given for bus use, followed by convenience, lack of parking problems and cost advantage over cars;
- the ranking (in descending order) of 'best factors about using buses' was: convenience to home/work, service frequency/reliability, lack of parking problems, comfort, and helpful drivers;
- dominant reasons given for car usage instead of bus were 'greater convenience and need to carry parcels'. Ease of parking, unsuitability of bus timetables, and the need for car during the day were also given as significant reasons for car usage; and
- the dominant factor discouraging car users from using buses was the restrictive nature of bus timetables. Other significant factors given were that the bus took too long, the bus stop location was inconvenient and the bus did not serve the desired destination.

[14] Metro submission, p11.

[15] Metro submission, p68.

[16] Metro submission, Appendix F, p69.

3.5 Metro Patronage Initiatives

The continual decline in patronage has been a major concern for Metro. As discussed above, Metro cites high levels of unemployment and a net decline in population as two key contributors to this outcome.[17] Projections of patronage trends by Metro forecast a fall in average public transport trips per person of 27-30 per cent in the three centres over the next 15 years.[18]

In addition to high levels of unemployment and a net decline in population, a number of factors arising from the New Tax System may also adversely affect Metro's patronage level. These include:

- ❖ expected falls in car purchase prices around 10 per cent;
- ❖ fare increases as a result of the net effect of GST; and
- ❖ increase of disposable income because of reductions in personal tax rates.

Metro estimates that the combined effect of the above factors would result in a reduction in patronage of approximately 2-3 per cent in the short to medium term.[19]

To ensure its services better meet customer needs, thus enhancing patronage, Metro has implemented various service level and service quality improvements since 1996. The key service initiatives include:

- ❖ doorstopper services;
- ❖ shopper services;
- ❖ courtesy zone;
- ❖ Burnie area service enhancement; and
- ❖ summer holiday services.

Metro acknowledges that despite these initiatives, patronage has continued to fall. Metro is currently considering a series of initiatives recommended by the Booz Allen & Hamilton (BAH) 'Demand Forecast' consultancy to increase future patronage. The initiatives under four main headings are:[20]

- ❖ service enhancement initiatives;

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[17] Metro Annal Report 1998-99.

[18] Assuming no changes in fares (real terms), service levels (or other service initiatives) and in current transport and development policies. (Source: 'Demand Forecast' Project conducted by Booz Allen & Hamilton).

[19] Metro submission, p21, assuming the net effect of GST is 4.7 per cent.

[20] Metro submission, p16.

- asset and infrastructure initiatives;
- market, information and customer care initiatives; and
- monitoring, research and planning initiatives.

These initiatives are to be developed and appraised in more detail as part of the Metro forthcoming Corporate Plan review. Metro estimates that:[21]

- a once-off patronage increase in the order of 10 per cent from the package of service and marketing and information initiatives might be expected if fare levels and the total amount of service provided are unchanged;
- a 50 per cent increase in off-peak services overall might result in a total patronage increase in the order of 5-10 per cent; and
- a reduction in (real) average fares of 50 per cent might result in a patronage increase in the order of 15-20 per cent.

Metro states in its submission that:[22]

> These three effects are largely additive, but are of a once-off nature. If all were implemented, they would broadly counteract the projected decline in 'base' demand over the next 15 years, ie in 15 years time the total patronage level would be similar to the current level. However, if less substantial (or no) improvements in service levels and/or reductions in fares are implemented, then it is probable that overall patronage will continue to fall, despite any efforts of Metro management.

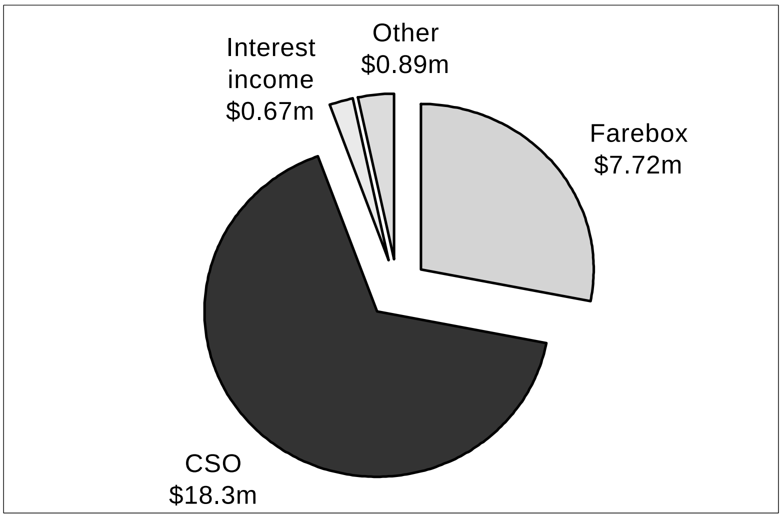
[21] Metro submission, p16.

[22] Metro submission, p16.

Chapter 4 - Metro Revenue: Fares and Government Funding for CSOs

Metro's revenue comes mainly from two sources – fare revenue and Government funding for CSO's. The composition of revenues for 1998-99 is illustrated in Figure 4.1 below.

Figure 4.1: Metro Revenue 1998-99



Source: Metro Annual Report 1998-99, figures do not include revenue from subsidiary, Hobart Coaches.

Figure 4.1 shows that two-thirds of Metro's 1998-99 total revenue was from CSO funding, with about 28 per cent of total revenue coming from fares paid by passengers.

This chapter discuses fare revenue and fares in Section 4.1, and CSO funding in Section 4.2.

4.1 Fare Revenue

There have been two Metro fare increases since 1991:

- ❖ in January 1995: an increase of around 10 per cent on adult and child cash fares and around 5 per cent on adult and child 10-trip fares; and
- ❖ in July 1996: an increase of around 10-15 per cent on adult and child cash fares and around 20 per cent on adult 10-trip fares (to standardise the discount on these fares at 20 per cent relative to cash fares).

Following an initial increase in total fare revenue in 1996-97, Metro's revenue has continued to decline. Metro's total fare revenue since 1995-96 is summarised in Table 4.1 below. The decline in revenue, including revenue from charter services, for the last three years is consistent with the falls in patronage for the same period.

Table 4.1: Metro Fare Revenue

	1998-99	1997-98	1996-97	1995-96
Fare Revenue(incl charter)	$7.72m	$8.029m	$8.428m	$7.857m

Source: Metro Annual Reports 1995-96, 1996-97, 1997-98, & 1998-99.

4.1.1 Current Fares

The same schedule of fares applies in Hobart, Launceston and Burnie. The current fares are set out in Table 4.2.

Table 4.2: Fares as at January 2000

Category	Single	Daily	10 Trip	10 Day	Month
Adult					
Section 1-2	1.20		9.60		
3-4	1.60		12.80		
5-7	1.90		15.20		
8-10	2.10		16.80		
11-15	2.80		21.60		
Off-peak multi trip		3.10		24.00	
Adult Concession					
All sections	1.20		9.60		
Concession off-peak multi-trip		1.90		15.20	
Seniors all day multi-trip		2.10		18.00	
Family					
Family off-peak multi-trip		9.00			
Children & School Students					
Under 5 years of age			no charge		
- other than to/from school or day care centre					
- day care centre group travel	.60				
Child Under 16 years of age					
- all sections	1.20	1.90	9.60		38.40
Tertiary Students (full time)					
Section fares	As per adults		10.00		40.00
Tertiary off-peak multi-peak		1.90		15.20	
Parcels					
- other than passengers' luggage of approved size & weight		1.20			

Source: Metro submission, p26.

The Metro fare structure comprises five fare types (single, daily, 10 trip, 10 day and monthly) and six fare levels (adult, adult concession, family, children and school

students, full time tertiary students and parcels). Fares vary according to the number of sections travelled and time of travel (ie. some off-peak fares are available).

4.1.2 Fare Comparisons

4.1.2.1 Private operators

In the 1996 Investigation, the Commission found that Metro's fares were generally set below the level that would apply in a private operation. For the equivalent distance, Metro's fare was 6 per cent to 36 per cent lower than seven of the eight private operators studied.

While Metro's fares remain constant since 1997, private operators have since increased their fares. Metro notes that as a result, the difference between private operator and Metro fares have widened. Metro is of the view that:[23]

> These fare differences have now assumed greater importance, given that the Government's policy of moving towards equal treatment of Metro and private operators.

4.1.2.2 Interstate public operators

A recent study commissioned by Metro found that Tasmanian bus fares are among the lowest of all major Australian capital cities. Table 4.3 shows the most recent (1998-99) data available on average fares per adult (non-concession) boarding. Using full fare adult data avoids the difficulties in comparisons associated with differences in concession fare policies. The table shows that Metro average adult fares are the lowest of all capital cities.

Table 4.3: Fares as at January 2000 (Average adult fare comparisons, Australia 1998-99)

City	Operator	Average Fare/ Boarding ($)	Notes
Sydney	State Transit	1.47	Based on 1998/99 STA Sydney bus data
Newcastle	State Transit	1.62	Based on 1998/99 STA Newcastle bus only data
Brisbane	Brisbane Transport	1.88	Based on 1998/99 Brisbane Transport bus only Ticketing Data
Canberra	ACTION	1.95	Based on July/August/September 1999 data
Perth	Various	1.53	Advice from Transperth/WA DoT. Bus services only.
Hobart	Metro	1.28	Metro/BAH figures
Launceston	Metro	1.38	
Burnie	Metro	1.29	
All	Metro	1.30	

Source: BAH Study, Metro submission, p40.

[23] Metro submission, p28.

However, the differences in fares as shown in Table 4.3 may also reflect different lengths of trips travelled.

4.1.3 Elasticities of Fares and Demand

Both Australian and international evidence indicates that the fare elasticity for urban bus services in the short run is relatively inelastic, around (-)0.3. (That is, patronage would decline by 3 per cent if fares were increased by 10 per cent). It is also found that fare elasticities are generally similar between cities and countries.

Based on a recent study,[24] Metro concludes that in the context of its operation:[25]

- ❖ overall fare elasticities for Metro's three centres would be expected to be about (-)0.3 to (-)0.4 in the short run (ie within 3-6 months), and around (-)0.5 in the medium run;
- ❖ peak period elasticities would be around two-thirds of these averages, off-peak elasticities up to 1.5 times higher than these averages;
- ❖ elasticities for adult concession groups would be up to 1.5 times higher than these averages, with elasticities for other groups being lower than the averages; and
- ❖ elasticities will be higher than the averages for shorter-distance trips (up to 2-3 kms), lower for medium/longer trips.

Metro notes that the implication of these fare elasticities is that the revenue-raising impact of any fare increases is likely to be rather modest.[26] Metro estimates that, for example, a 10 per cent across-the board (real) fare increase would result in:[27]

- ❖ a loss in patronage (in medium term) in the order of 5 per cent, but relatively higher for adult concession passenger, lower for full adult passengers; and
- ❖ a consequent increase in fare revenue of around 5 per cent (about $350 000 - $400 000 pa).

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[24] Conducted by BAH commissioned by Metro.

[25] Metro submission, p43.

[26] Metro submission, p31.

[27] Metro submission, p31.

4.1.4 Issues

4.1.4.1 Indexation of fares

Under the 1997 Order, Metro's fare increase is indexed to CPI.[28] Metro submits that the CPI basis is unsatisfactory and the index utilised by the private bus industry better reflects actual circumstances affecting bus operations, hence, should be used for future fares adjustments.[29]

4.1.4.2 Distance-based fares

In the 1996 Investigation, the Commission recommended that Metro's fares should reflect distances travelled. In particular, the Commission recommended that:

- the fare for 11-15 sections of travel should be 2 1/2 to 3 times that for 1-2 sections, with appropriate intermediate gradations of fares for other section groupings;
- section boundaries should be adjusted to obtain a better relationship between the number of sections and distance travelled; and
- fare adjustments should be small and regular (ie annual).

Metro is of the view that adjusting fare relativities between trips of different lengths would help move Metro's fare/distance structure closer to that of Tasmanian private operators. Metro submits that the existing section-base fare structure should be retained in addition to adopting the Commission's earlier recommendations as discussed above.[30]

4.1.4.3 Social impact of fare increase

As discussed in Chapter 3, the majority of Metro's passengers are from low income or welfare recipient households. Metro submits that any significant increases could severely affect those people and may consequently restrict their mobility altogether. Further, Metro observes that:[31]

> In such circumstances demand for services will decline and pressure to reduce or remove poorly utilised services will increase, which if successful will result in deterioration of services and in further patronage losses.

Metro submits that the Commission takes into consideration the social impacts of any fare increases in developing its recommendations.

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[28] See discussion on this issue in Chapter 2.

[29] Metro submission, p33.

[30] Metro submission, pp31 and 33.

[31] Metro submission, pp34.

The Commission is seeking comments on:

- *the appropriate index for future Metro fares adjustments;*
- *the appropriate basis on which Metro's future fares are to be set; and*
- *the impact of fares increase on Metro's passengers who are from low income or welfare recipient households.*

4.2 Community Service Obligations

Effective from 1 July 1997, the then Minister for Finance issued a Declaration of CSOs to the, then, MTT. A Contract for the provision of CSOs was signed on 31 October 1997. On establishment of Metro Tasmania Pty Ltd, the Contract was assigned[32] to the newly corporatised body. The Metro Tasmania Act also makes provision for the Minister to enter into agreements with the Company, consistent with its principal objective, for the provision of services.

4.2.1 Current CSOs

The CSOs declared fell into two categories:

- *Concession CSOs* – ie, concessions provided to specified categories of passengers including school children and pensioners; and
- *Price/Service CSOs* – ie, the differential between a commercial fare and the full adult fare charged by Metro, and for the provision of non-commercial bus services provided by Metro (including late night services, higher frequency in-day, weekday and weekend services).

The services required to be undertaken were those that were in existence as at the date of the signing of the Declaration of the CSOs with fares required to be consistent with those provided in the *Government Prices Oversight Commission (Metro Fares) Order 1997*. The standards and quality of service under the Contract are defined to be those as specified in Metro's Customer Service Charter dated 27 June 1997, as updated from time to time. The Contract also:

- requires Metro to comply with all relevant legislation, licence conditions and any other obligations detailed in its Customer Service Charter;
- maintain its vehicles in good mechanical order;
- supply the Minister with quarterly patronage reports;

[32] *Metro Tasmania (Transitional and Consequential Provisions) Act 1997*, Section 9.

- details of scheduled trips not undertaken, and the reasons for the non-performance.

Schedule 4 of the Contract sets out the level of funding for the three-year period, being for:

- 1997-98 - $18.824 million;
- 1998-99 - $18.3 million; and
- 1999-2000 - $18.3 million.

adjusted by an agreed appropriate index, with the amounts being payable monthly in advance.

The Contract also includes a provision for performance reviews in relation to its service delivery, and the Minister may adjust the funding to reflect any net savings to Metro in the event it fails to deliver the required services.

4.2.2 Future CSO Arrangements

Metro acknowledges that the range and value of concession fares is a matter for Government. However, it is of the view that it is important that the provision of these fares is supported by appropriate arrangements that recognise the full value of revenue foregone by Metro.

The current Contract expires on 30 June 2000. At this stage it is anticipated that the current Contract will be extended for one year. Metro has indicated that it is seeking a small number of amendments to the existing Contract. It is of the view that a truly commercial contract would include a ‘return on capital’ component in the price calculation. In addition, it is seeking to have the CSO payments indexed on the same basis as payments made to private contractors for the provision of concessions.

Metro considers that these amendments would simplify benchmarking against private sector passenger transport companies with a more direct comparison of costs and prices. Further, this would also be advantageous if at any future date competitive tendering for passenger transport services in Tasmania was undertaken as the full cost (ie operational costs plus costs of capital) would be known.

Metro[33] also notes that in considering any changes to concession fares, the elasticities for the adult concession group in particular is high. The issue of price elasticities for Metro is also discussed in section 4.1 above.

[33] Metro submission, p32.

Chapter 5 - Financial and Non-Financial Performance

5.1 Financial Performance

Table 5.1 below shows the trends in revenue, expenses and profitability over the three-year period 1 July 1996 to 1 July 1999 (the date of the most recent audited financial statements).

Table 5.1: Metro Tasmania Summary Profit and Loss Information ($ nominal)

	1996-97 $'000	1997-98 $'000	1998-99 $'000	1999-00 $'000 estimate
Fares Revenue (including Government CSO payments)	8 428	8 029	7 809	7 574
Other Revenue	2 399	6 079	1 541	1 581[1]
Deficit Funding/CSO Revenue[2]	18 099	18 324	18 300	18 725
Total Revenue	**28 926**	**32 432**	**27 650**	**27 880**
Expenses	**30 424**	**29 132**	**27 215**	**27 880**

Source: Metro Tasmania Annual Reports and Submission
Note 1: Includes contribution of $107 000 from Subsidiary.
Note 2: In 1996-97 the Government provided funding separately for student transport and to cover operating losses. In 1997 Metro and the Government entered into an agreement for the payment of CSOs for the three financial years 1997-98 to 1999-2000.

Metro notes in its submission that its operating expenditure per bus kilometre has improved[34] (29 per cent) over the previous 10 year period and that its unit costs have been reduced significantly[35] over the period since the 1996 Investigation (overall by 11 per cent). An underlying improvement in overall cost effectiveness has resulted in a general improvement in profitability over the same period. However, as a significant proportion of its income derives from Government CSOs and the Contract does not include an allowance for a return on equity, Metro's return on equity and return on assets, as shown in Table 5.2, remains below expected normal commercial benchmarks.

[34] Metro submission, p12.

[35] Metro submission, p20.

Table 5.2: Selected Financial Performance Ratios

Ratio	1998-99 Actual %	1999-00 Estimate %	2000-01 Target %
Return on Equity	3.0	0.0	8.0
Return on Assets	2.2	1.3	5.0
Debt to Equity	43.5	39.5	35.3
Interest Cover	183.0	100.0	419.0

Source: Metro submission

5.1.1.1 Return on equity and return on assets

The return on equity and return on assets indicators for 1998-99 and 1999-00 are well below expected commercial targets due to the structure of the funding arrangements for the CSOs, which comprise over one half of all Metro's receipts.

As discussed in section 4.2, Metro is seeking to have included a 8 per cent return on equity component included in its CSO funding calculations. On the assumption that this amendment is made to the Contract for 2000-01, Metro is targeting an 8 per cent pre-tax nominal rate of return on equity. This rate is marginally higher, one per cent, than the current nominal Commonwealth 10-year Bond rate yield, the most commonly used an estimate of the risk free rate.

In this regard, it is interesting to note that the Independent Pricing and Regulatory Tribunal (IPART) in NSW in its 1999 report, *Public Transport Fares from 1 August 1999, Cityrail and STA Buses and Ferries*, stated[36]:

> In a competitive market the cost of capital could be assessed by examining the rates of returns earned by other bus or ferry companies operating in the same environment. However, most of the services provided by STA are in specific Sydney and Newcastle metropolitan regions where there are few, if any, competitors.

IPART did not attempt to calculate or provide an estimate of an appropriate rate of return for the State Transit Authority, stating it would only consider allowing a rate of return for the STA when cost savings are further advanced.

The Independent Pricing and Regulatory Commission (IPARC) in the Australian Capital Territory also undertook a review of the ACT's passenger bus service, ACTION. In making its determination IPARC did not specifically calculate or assess an appropriate rate of return for ACTION. However it did note that little evidence had been furnished to 'suggest ACTION has applied a rigorous assessment of new investments in terms of prescribed rate of return criteria'.

[36] IPART, *State Transit Authority, Report to the Premier and Determination*, p 17.

As IPART notes, estimating the rate of return is difficult in the public transport sector where there is little or no competition and the revenue risks are ameliorated to a large extent where in many cases over half of the entity's revenue is derived from Government sources.

5.1.1.2 Debt to equity ratio and interest cover

The debt to equity ratios for the three-year period, although on the low side for 2000-01 in particular, is within the range expected in a commercial environment (typically between 30 and 60 per cent, depending on the business and its risk profile). The debt to equity ratio is a matter for the Board and the Government as owner to consider.

Comments are sought on the appropriate risk adjusted rate of return for an equivalent service provider in the private sector, and if the rate of return for Metro should be greater or less than for a private sector commercial operator. That is, are there any considerations that would result in Metro having a higher or lower risk profile compared to its private sector counterparts.

5.1.2 Returns to Government

The Government's policy in relation to its GBE and State-owned companies (SOC) is for dividend payments equal to:

- at least 50 per cent of after tax profits; or
- an amount such that when added to income tax equivalent payments the total of dividends and tax equivalent payments will equal 70 per cent of pre-tax profits.

Metro have not been subject to the dividend payment policy on the basis that it has been running on a break-even basis with payments for CSOs excluding an element for return on assets. However, Metro has been subject to the full tax equivalent regime, ie both income tax and wholesale sales tax equivalents, and also subject to guarantee fees. Table 5.3 shows the current and projected returns to Government for the period 1998-99 to 2000-01.

Table 5.3 Returns to Government

	1998-99	1999-00	2000-01
Wholesale sales tax equivalent	360	468	-
Guarantee Fees	38	38	34
Dividends	-	-	1 300

Source: Metro submission

Note 1: Wholesale sales tax equivalent regime will cease with the commencement of the New Tax System

The projected payment of a dividend in 2000-01 is predicated on Metro being provided with a return on assets component in the costings for its CSOs. As discussed in Chapter 4 this matter has yet to be finalised. Metro is of the view that the inclusion of this

component and then a requirement for the payment of a dividend (of up to 100 per cent of its after tax profits) provides for a more transparent regime and more akin to private sector requirements.

5.1.3 Non-Financial Performance Indicators

The non-financial performance indicators are reflective of the underlying cost structures of Metro. The actual result and the forecast trends for the current and next financial year in relation to employee numbers are relatively stable.

Table 5.4: Non-Financial Performance Indicators

	1998-99	1999-00 estimate	2000-01 estimate
Employees (FTE) per million kms	36.2	35.3	35.5
Employees per peak bus	1.9	2.0	2.0
Vehicles in excess of maximum daily demand	na	11.2	11.2
Kilometres per vehicle	na	47 935	48 579
On-time performance	96	93	96

Source: Metro

Private sector and public sector operators summary comparative information on non-financial performance indicators is provided in Appendix J of the Metro submission.

It is noted that Metro is planning to review a number of areas with the intention of improving overall efficiency. These issues are discussed in section 5.2.2.

5.2 Cost Efficiencies

At the time of the 1996 Investigation, Metro's costs exceeded its fare-box revenues and these losses were subsidised from the Consolidated Fund. However, it was recognised that these losses were as a result of Metro's requirement to provide concessions and non-commercial services, ie the CSO component, as well as having costs in excess of an efficient level.

As noted above, since the 1996 Investigation, Metro has achieved significant cost savings. Metro states in its submission[37] that the key indicators of trends over the past 10 years are:

- a decline in operating expenditure per bus kilometre of 29 per cent;
- a reduction in unit costs for drivers over the period from 1995-96 of 13 per cent; and

[37] Metro submission, p12.

- ❖ a decline in bus repairs and maintenance unit costs for the period since 1992-93 of 40 per cent;

resulting in:

- ❖ a decline in the cost to Government for the provision of services in the order of 14 per cent; and

- ❖ a decline in the Government payment per passenger trip of one per cent.

Table 5.5 illustrates the extent and timing of the cost savings over the period to 1998-99.

Table 5.5: Cost Efficiencies

Cost Category	Change in Unit Costs (Real Terms) %		Comments
Drivers	-11.3	-12.8	Most of reduction since 1995-96.
Bus Running	-1.4	-7.6	Largely dependent on price of fuel.
Bus Repairs & Maintenance	-38.2	-21.3	Continuous significant decline since 1993-94.
Overheads	-12.5	+5.2	Declined in period up to 1995-96, some increase since then due to an 11 per cent decline in peak buses and additional charges incurred as a result of corporatisation in 1998.
Standardised Costs (excluding Bus Capital Charges)	-14.5	-9.5	Continuing steady decline throughout period (except 1994-95).
Bus Capital Charges	-27.9	-34.0	Reached peak in 1994-95 (with purchase of new buses) but has declined rapidly since (with ageing of fleet).

Source: Metro submission

Bus capital charges increased over the period to 1994-95 as new buses were purchased. However, these charges have since declined materially since then resulting in an average decline of 27 per cent for the seven year period to 1998-99. Overheads, on the other hand, declined substantially in the early years and have risen again slightly in the last few years. Metro notes[38] that (excluding bus capital charges) its standardised costs have reduced by almost 10 per cent since 1995-96 (the year before the 1996 Investigation) and approximately 15 per cent since 1992-93 (the first year for which data is available). Cost efficiencies have been achieved in a number of areas, including staffing (429 in 1996 to 375 in 1999) resulting in a reduction of unit costs (11 per cent in real terms, since 1996). The key areas though have been considerable reductions in the costs of drivers and bus repairs and maintenance.

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[38] Metro submission, Appendix J p77.

Metro[39] also notes that it continues to compare unfavourably with private sector operator costs. The reasons for this are apparent from analysis of Table J1 in Appendix J of the Metro submission, where average labour costs, drivers per bus hour costs, overheads and bus repairs and maintenance costs for Metro are all above the private sector benchmark levels.

5.2.1 Cost Recoveries and Interstate Comparisons

During 1998-99 Metro participated in an Australian Bus Benchmarking Assessment, conducted by Booz-Allen & Hamilton. This assessment covered the three separate Metro operations, four interstate public sector bus operators and six urban private sector operators. Metro notes[40] that it was ‘mid-range’ in 1998-99 compared to other benchmarked operators in terms of cost recovery, ie the ratio of non-government returns to total operating costs. However, Metro notes that the cost recovery ratio indicator needs to be considered in tandem with the interstate comparison of average total fare levels (as opposed to average fares for given classes of passengers), where Metro rates as being among the lowest. Issues in relation to fares are more fully explored in Chapter 4 above and in Appendix C of the Metro submission. Appendix J of the Metro submission provides a more detailed assessment of Metro’s operational and cost efficiencies.

In making any comparison of public transport, Metro also cautions that care needs to be taken in assessing how revenues and costs are defined as it is acknowledged that accounting conventions provide for a variety of treatments of a number of items. Appendix C (section C2) of the Metro submission provides a detailed discussion of the comparative assessments with particular emphasis on public sector operators that generally operate in the major urban centres.

Metro notes[41] that on Industry Commission estimates Tasmania is in the mid-range and closely comparable with Canberra, Newcastle and Brisbane for the period 1992-93 through to 1996-97 also based on Industry Commission estimates. Only Sydney had a cost recovery of greater than 50 per cent (Sydney buses averaging approximately 57 per cent) over this period. However, more recent estimates based on the Booz-Allen Hamilton study have a number of operators at significantly below the 1996-97 Industry Commission estimates. For example, recent estimates for ACTION[42] in the ACT are in the order of 23 per cent, with Tasmania[43] reflecting an average of 30.3 per cent for the 1998-99 financial year. The differences between the two estimates appear to arise from

[39] Metro submission, p20.

[40] ibid p 29.

[41] Metro submission, Appendix C p43.

[42] Metro submission, Appendix C p43 – IPARC Draft Fare Determination for ACTION.

[43] Metro submission, Appendix C p43 - Australian Bus Benchmarking Assessment.

differences in methodologies in calculation. The Industry Commission estimates are based on a standardised formula. The more recent estimates are based on a range of entity specific methodologies, which has resulted in a broader range of estimates. The estimates and the methodologies used in each study are provided in Appendix C of the Metro submission.

5.2.2 Cost Efficiency Initiatives

Metro states in its submission that it 'will continue to introduce measures that provide for greater utilisation in the area of human resource management, fleet management, and depot infrastructure.' Details of Metro's proposed initiatives are discussed in section 4.3 of its submission. These initiatives include:

- review of vehicle usage to establish if utilisation can be improved;
- establish alternatives to owning and operating depot facilities;
- reduce 'dead-running' kilometres; and
- examine work practice changes and extension in part-time, casual and temporary employment arrangements.

A number of proposed patronage enhancement initiatives and the capital investment program also have cost efficiency implications. Patronage initiatives are discussed in Chapter 4 and the capital investment program is discussed in section 5.3 below.

5.2.3 Summary

Metro appears to have achieved material levels of cost savings over the current pricing period and better than those of other publicly owned bus operators that participated in the recent benchmarking study. However Metro acknowledges that there remains significant cost gaps between its costs and participating efficient private sector operators.

Comments are sought on:

- *the appropriateness of setting benchmark targets for cost efficiencies at the level of efficient private sector operators, and/or the appropriate efficiency targets across all areas of Metro's operations; and*
- *the appropriate level of cost recovery for Metro.*

5.3 Capital Program

5.3.1 Bus Fleet

As Metro discusses in its submission[44] the bus fleet represents the main commitment in capital investment over the next two to three years. Since 1986 Metro has had a planned replacement program. However, with increased efficiencies in bus operations there has been a reduction in the required number of buses and drivers. Consequently no buses were purchased in the three-year period to 31 December 1999. The replacement program will recommence in 2000 with the purchase of four buses and a further 10 purchases are planned for the following year. Buses surplus to requirements are sold in accordance with Metro policy.

5.3.2 Other Assets

The other key asset that will require significant re-investment is the ticketing system commissioned in 1988. A software upgrade in 1995-96 has extended its life to 2000. It is expected a new system will cost in the order of $600 000.

As indicated above, Metro also intends to review its property assets, to establish if there are more cost effective options are viable.

5.4 GST Implications

The Terms of Reference for this Investigation require the Commission to consider the implications for Metro's pricing policies of the Commonwealth's GST and other elements of the New Tax System.

As discussed in Chapter 1, Metro is subject to the GST and, under the *New Tax System Price Exploitation Code (Tasmania) Act 1999*, the *Price Exploitation Guidelines*[45] issued by the Australian Competition and Consumer Commission. Under these Guidelines Metro is only able to increase its prices by the net impact of the GST under the New Tax System. That is, any change in price must take into account the removal of other taxes under the New Tax System such as wholesale sales tax (or wholesale sales tax equivalent (WSTE)) and the fuel duty rebate. Metro is currently subject to the WSTE regime under its enabling legislation. Wholesale sales tax equivalent is payable on a range of inputs. However, it should be noted that passenger buses are exempt under Item 63 of the *Sales Tax (Exemptions and Classifications) Act 1962* and that this exemption has been extended to Metro under the State's WSTE regime.

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[44] Metro submission, p22.

[45] *Price Exploitation and the New Tax System, General Principles, Information and Guidelines on When Prices Contravene Section 75AU of the Trade Practices Act 1974,* Australian Competition and Consumer Commission 1999.

GST is a 'pass-through' item for business in that it is required to pay GST on its inputs and charge GST on its outputs. However, the amount remitted to the Australian Tax Office (ATO) is the net amount (GST collected minus GST paid). This differs from the current sales tax regime whereby the cost is borne by the business.

Metro's modelling[46] indicates that the net impact of the New Tax System on its prices will be approximately 4.7 per cent. However, as discussed in section 4.1, any price increase is likely to result in a decrease in patronage. Metro also believes the decrease in patronage will be influenced by other aspects of the New Tax System, specifically the increase in net disposable incomes (arising from changes in benefit payments and decreases in personal taxes) and reductions in the price of motor vehicles.

A key issue is whether the Price Exploitation Guidelines prohibit the increase in an individual fare of 4.7 per cent or whether the Guidelines can be interpreted to apply to the total fare-box revenue, ie an average across all fares. Metro regards this matter of specific concern, especially when considered in light of ACCC recommendations on rounding of prices.

[46] Metro submission, p21.

Appendix A: Terms of Reference

GOVERNMENT PRICES OVERSIGHT ACT 1995

INVESTIGATION INTO THE PRICING POLICIES OF METRO TASMANIA

The Terms of Reference for the investigation to be conducted by the Government Prices Oversight Commission ("the Commission") into the pricing policies of Metro Tasmania Pty Ltd (Metro) are outlined below. These Terms of Reference address each of the issues outlined in section 25 of the *Government Prices Oversight Act 1995* ("the Act").

The Functions and Other Activities of Metro

The main objectives and activities of Metro, as outlined in the *Metro Tasmania Act 1997* and the Metro Corporate Plan, 1999-2002, are as follows:

(a) to provide road passenger transport services in Tasmania and to operate those services in a manner consistent with sound commercial practice;

(b) to perform on behalf of the State its community service obligations in an efficient and effective manner, as specified in the Community Service Agreement; and

(c) to perform any other objectives specified in the *Metro Tasmania Act 1997*.

The Pricing Policies and the Monopoly Service to be Investigated

The Commission is to investigate the pricing policies associated with the current provision of scheduled route services by Metro in the metropolitan areas of Hobart, Launceston and Burnie and the town of Ulverstone.

The Date of Completion

The Commission must provide a copy of the Final Report required under section 35 of the Act in respect of the Metro investigation by 2 June 2000.

Additional Matters to be Taken into Account

In addition to taking into account the matters explicitly referred to in section 31 of the Act, the Commission must also take into account the following issue when conducting the Metro pricing investigation:

- the effect of the Goods and Services Tax and other elements of the New Tax System on the pricing policies of Metro; and

- National Competition Policy requirements as they apply for regular passenger transport services.

Requirement for the Commission to Make Recommendations

The Final Report provided by the Commission under section 35 of the Act must contain recommendations in relation to appropriate maximum prices (as defined in section 4 of the Act) to be charged by Metro in respect of these bus services during the period of three years after the completion of the Final Report.

Draft Report

At an appropriate time during the investigation, the Commission must make available a draft Report.

MATTERS TO BE CONSIDERED

The *Government Prices Oversight Act 1995* (Section 31) requires that:

"In an investigation, the Commission must consider the following:–

(a) the cost of supplying or providing the monopoly service;
(b) any interstate or international benchmarks for prices, costs, revenues and return on assets in bodies supplying a service similar to the monopoly service;
(c) the need to protect consumers from the adverse effects of the exercise of monopoly power by a monopoly provider in relation to prices, pricing policies and standards of service in respect of the supply of the monopoly service;
(d) where appropriate, the need for a reasonable return to the State (including the payment of dividends) on the assets of a monopoly provider;
(e) the need for efficiency in the supply of the monopoly service for the purpose of benefiting the public interest through a reduction in the cost of supplying the monopoly service;
(f) the effects of inflation;
(g) the need for the monopoly provider to be financially viable;
(h) the impact on pricing policies of any borrowing, capital, dividend and tax equivalent obligations of the monopoly provider, including obligations to renew or increase assets;
(i) any ministerial charter that applies to the monopoly provider;
(j) any community service obligations of the monopoly provider;
(k) the quality of the supply of the monopoly service;
(l) the matters set out in the terms of reference;
(m) any other matter the Commission considers relevant."

Appendix B: GPOC Legislative and Policy Framework

National Competition Policy

The Government Prices Oversight Commission was set up as part of Tasmania's commitment to the National Competition Policy (NCP) Agreements which were signed by the Council of Australian Governments (COAG) in April 1995.

The purpose of the NCP is to promote competition in the interests of efficiency and economic growth, while dealing with social objectives and concerns about market failure. If there is no effective competition for supply of a particular Government service, there should be independent oversight of prices. Commonwealth prices oversight is to apply in the absence of an appropriate State body.

The philosophy of the NCP Agreements was that a prices oversight body should have the following characteristics:

(a) *it should be independent from the Government Business Enterprise whose prices are being assessed;*

(b) *its prime objective should be one of efficient resource allocation but with regard to any explicitly identified and defined community service obligations imposed on a business enterprise by the Government or legislature of the jurisdiction that owns the enterprise;*

(c) *it should apply to all significant Government Business Enterprises that are monopoly, or near monopoly, suppliers of goods or services (or both);*

(d) *it should permit submissions by interested persons; and*

(e) *its pricing recommendations and the reasons for them should be published.*

The Tasmanian Government Prices Oversight Commission has been set up to fulfil these principles.

The Government Prices Oversight Act

The *Government Prices Oversight Act 1995* is the legislative authority for the Commission. It provides for the investigation of pricing policies of Tasmanian GBEs and Agencies that provide monopoly services and goods, and for the recommendation of maximum prices.

Conduct of Investigations

The Commission must conduct an investigation in accordance with a requirement to investigate given by the Minister (the Treasurer), the relevant terms of reference and the Act.

Subject to these requirements, the Commission may conduct an investigation in any manner it considers appropriate. It may consult with any person, hold hearings and seminars, and conduct workshops.

It may obtain information through submissions and may require information to be provided to it under Section 29 of the Act.

Confidentiality of Information

In regard to information provided in response to a Section 29 request, the Commission may give directions prohibiting or restricting the publication of material provided to it.

As a matter of policy, the Commission will not publish material which is provided to it in confidence. Further, the Act prohibits the Commission from publication of any material which, if published, could damage the commercial interests of a monopoly provider.

Reports

The Terms of Reference may require the release of a Draft Report (as has been required in this Investigation). The Final Report must contain the Commission's recommendations in regard to the maximum prices to be charged by the monopoly provider for the period of three years after the completion of the report.

Price Setting

The role of the Commission is to recommend appropriate maximum prices based on economic principles. The final decision on the level of maximum prices rests with Government.

Upon receiving the Commission's recommendations, the portfolio Minister, after consulting with his or her cabinet colleagues and the monopoly provider, formulates an Order prescribing maximum prices. The Minister's Order may also take into account the social consequences of the prescribed maximum price levels and other factors. The Minister's Order is disallowable by either House of Parliament.

The Order also extinguishes previous powers for setting prices.